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Supreme Court of the United States.

OCTOBER TERM, 1903.

No. 482 1141.

WINFIELD S. GREGG,

Appellant,

vs.

METROPOLITAN TRUST COMPANY ET AL.,

Appellees.

Brief of the Respondents Metropolitan Trust Company of the City of New York, individually and as Trustee, Mercantile Trust Company and F. G. Hallet in answer to the Petition.

HERBERT PARSONS,

Of Counsel for the Respondents.

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Supreme Court of the United States,

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No.

WINFIELD S. GREGG,
Appellant,

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METROPOLITAN TRUST COMPANY ET AL.,
Appellees.

BRIEF OF THE RESPONDENTS METROPOLITAN TRUST COMPANY OF THE CITY OF NEW YORK, INDIVIDUALLY AND AS TRUSTEE, MERCANTILE TRUST COMPANY, AND F. G. HALLET IN ANSWER TO THE PETITION.

Statement of the Case.

To the petitioner's statement of the case there should be added the following:

The petitioner Gregg has not claimed only against the proceeds of the sale. He has made claim also against the surplus earnings of the Receiver, and that claim has not yet been adjudicated, but is still reserved to him (Record, pp. 43, 44, 160, 161, 182, 183,

196, 236, 252, 346 and 347). His claim and reservations in this regard are considered *in extenso* under First Point (*infra*). The Receiver did have surplus earnings sufficient to pay petitioner's claim. This does not appear in the record.

The order appointing the Receiver did not, as alleged by the petitioner on page 13 of his brief, authorize the Receiver to borrow $35,000 to pay such claims as Gregg's. Although that order did authorize him to pay preferential supply claims (Record, p. 25, lines 9, 31–35), the borrowing of the $35,000 was authorized simply to pay obligations accrued and accruing upon equipment trust and payrolls (Record, p. 25, lines 37–44). The order authorizing him to borrow $200,000 on Receiver's certificates omitted the words "materials " and supplies furnished said railroad company," although these words were in the petition and although all the other words used in the petition were repeated in the order (Record, pp. 28, 30). Moreover, both the petition and order were to the effect that the Receiver should only borrow such sums "as he may find necessary" (Record, pp. 29, 31). A month later he, apparently, had found it unnecessary to pay supply claims (Record, pp. 35 & 37).

FIRST POINT.

The claim of the petitioner Gregg was not made final in the Circuit Court of Appeals. He has a claim against another fund—namely, the surplus earnings of the receivership. The question presented by him in this proceeding is, accordingly, still an academic one.

The petitioner Gregg demanded not only that his claim be adjudged a lien upon the property prior to the bonds, but that the Receiver should be directed to pay it (Record, pp. 43, 44). The petitioner obtained a stipulation that the decree to be entered on his intervening petition should be

> " without prejudice to any claim said Gregg may
> " have to be paid as a six months' claimant out of
> " surplus earnings, if any, of the receivership."
> (Record, pp. 160, 161.)

This reservation has been continued to date and Gregg still has the opportunity to have his claim paid out of the surplus earnings of the receivership. The original decree of the Circuit Court of March 10, 1900, reserved it in the expression at the end of the first paragraph of Article XXIV. of that decree

> " without, however, prejudice to such rights as
> " may exist in favor of holders of preferential
> " claims to have any net earnings of the receiver-
> " ship applied to the payment of their claims."
> (Record, pp. 182, 183.)

The reservation was continued in the later decree of the Circuit Court of November 25, 1901, in the same words (Record, p. 236).

Neither the decree of March 10, 1900, nor of November 25, 1901, settled the receiver's accounts, but questions

> " including the discharge of the receiver and the
> " settlement of his accounts "

were reserved for future adjudication (Record, pp. 196, 252).

The reservation was further continued in the decree of confirmation and distribution, entered October 8th, 1902 (Record, pp. 346, 347).

The receiver did have surplus earnings. They do not appear in the record, but their existence is a fact. If those surplus earnings were appropriated to pay the petitioner's claim, they would more than do it.

The law as laid down by this Court is clearly to the effect that the surplus earnings of the receivership shall be appropriated to the payment of such a claim.

Burnham vs. Bowen, 111 U. S., 776.
V. & A. Co. vs. Central Railroad, etc., Co., 170 U. S., 355 at 365.

> " It is immaterial in such case, in determining the right to be compensated out of the surplus earnings of the receivership, whether or not during the operation of the railroad by the company there had been a diversion of income for the benefit of the mortgage bondholders, either in payment of interest on mortgage bonds or expenditures for permanent improvements upon the property. Nor is the equity of a current supply claimant in subsequent income arising from the operation of a railroad under the direction of the court affected

> by the fact that while the company is operating its road its income is misappropriated and diverted to purposes which do not inure to the benefit of the mortgage bondholders and are foreign to the beneficial maintenance, preservation and improvement of the property. This principle finds support in Miltenberger v. Logansport Railway Company, 106 U. S., 286, 311, 312, the decision in which case was approvingly referred to in Union Trust Company v. Illinois Midland Company, 117 U. S., 434, and in the recent case of Thomas v. Western Car Company, 149 U. S., 95, 110. * * * "

And again at page 369:

> " Whether, however, there was a diversion of income before the receivership, inuring to the benefit of the bondholders, the equity in favor of the coal company for payment out of subsequent income, as we have seen, survived and attached to the property when it was taken possession of by the receiver; and if a surplus of income was created by the operations of the road under the receiver, sufficient to satisfy the claims of the intervenors, the right to demand that the surplus income be applied in satisfaction of the claims in question was undoubted."

The petition, accordingly, should not be entertained for the petitioner has another remedy.

> *In re* Tampa Suburban Railroad Co., 168 U. S., 583, at 588.

SECOND POINT.

This Court has decided that in order to have preferential supply claims adjudged a lien upon the corpus it is necessary to prove a diversion of earnings.

(a) Upon what ground this Court decided to deny the petition in the case of Rhode Island Locomotive Works vs. Continentnl Trust Co. (187 U. S., 649), does not appear. But in that case the Circuit Court of Appeals for the Sixth Circuit had said (108 Fed., 5):

> " If the appellant is to obtain any relief, it
> " it must show: * * * second, that there are
> " net or current earnings now applicable to the
> " payment of such debts of income or that there
> " has been a diversion of the current earnings,
> " either before or since the receivership, which the
> " mortgagee should equitably restore."

The petition that was filed in this Court for a writ of *certiorari* to review the case was denied (187 U. S., 649).

(b) The petitioner admits that there are only two cases in this court in which he can claim a recognition of his contention, and names Miltenberger vs. Logansport Railway Co. (106 U. S., 286), and Union Trust Co. vs. Illinois Midland Co. (117 U. S., 434). He admits that in the latter case it does not affirmatively appear whether there had been any diversion of earnings by the company in favor of the bondholders (p. 11 of his brief). But he goes on to say: " This Court has never refused " to pay supply claims out of the corpus, on the ground " that there has been no diversion of earnings; and

" has never formulated any such doctrine " (p. 11 of his brief).

A re-reading of the expressions used by this Court will remind the Court that it has formulated such a doctrine, and has repeatedly stated the necessity of proving a diversion of earnings.

This Court said in Fosdick vs. Schall (99 U. S., 235):

> " Every railroad mortgagee in accepting his security impliedly agrees that the current debts made in the ordinary course of business shall be paid from the current receipts before he has any claim upon the income. If for the convenience of the moment something is taken from what may not improperly be called the current debt fund and put in that which belongs to the mortgage creditors, it certainly is not inequitable for the Court, when asked by the mortgagees to take possession of the future income and hold it for their benefit, to require as a condition of such an order that what is due from the earnings to the current debt shall be paid by the Court from the future current receipts before anything derived from that source goes to the mortgagees. * * *
>
> " * * * *The power rests upon the fact that in the administration of the affairs of the company the mortgage creditors have got possession of that which in equity belonged to the whole or a part of the general creditors. Whatever is done, therefore, must be with a view to a restoration by the mortgage creditors of that which they have thus inequitably obtained. It follows, that if there has been in reality no diversion, there can be no restoration; and that the amount of restoration should be made to depend upon the amount of the diversion.*" (Italics ours.)

Then come in chronological order the two cases *(supra)* on which the petitioner relies.

The expressions in the cases following the petitioner's cases are most important.

St. Louis & C. R. R. vs. Cleveland & C. Ry., 125 U. S., 673:

> "By the Court: The rule governing in all these cases was stated by Chief-Justice Waite in Burnham vs. Bowen, 111 U. S., 776, 783, as follows: 'That, if current earnings are used for the benefit of mortgage creditors before current expenses are paid, the mortgage security is chargeable in equity with the restoration of the fund which has been thus improperly applied to their use.' There has been no departure from this rule in any of the cases cited; it has been adhered to and reaffirmed in them all."

Kneeland vs. American Loan Co., 136 U. S., 97:

> "Because in a few specified and limited cases this court has declared that unsecured claims were entitled to priority over mortgage debts, an idea seems to have obtained that a court appointing a receiver acquires power to give such preference to any general and unsecured claims. It has been assumed that a court appointing a receiver could rightfully burden the mortgaged property for the payment of any unsecured indebtedness. * * * Can anything be conceived which more thoroughly destroys the sacredness of contract obligations? One holding a mortgage debt upon a railroad has the same right to demand and expect of the court respect for his vested and contracted priority as the holder of a mortgage on a farm or lot. So, when a court appoints a receiver of railroad property, it has no right to make that receivership conditional on the payment of other than those few unsecured claims which, by the rulings of this

court, have been declared to have an equitable priority. No one is bound to sell to a railroad company or to work for it, and whoever has dealings with a company whose property is mortgaged must be assumed to have dealt with it on the faith of its personal responsibility, and not in expectation of subsequently displacing the priority of the mortgage liens. It is the exception and not the rule that such priority of liens can be displaced. We emphasize this fact of the sacredness of contract liens, for the reason that there seems to be growing an idea that the chancellor, in the exercise of his equitable powers, has unlimited discretion in this matter of the displacement of vested liens."

Southern Railway vs. Carnegie Steel Co., 176 U. S., 284:

BY THE COURT: "But it may be safely affirmed, upon the authority of former decisions, that a railroad mortgagee, when accepting his security, impliedly agrees that the current debts of a railroad company contracted in the ordinary course of its business shall be paid out of current receipts before he has any claim upon such income; * * * and that, when current earnings are used for the benefit of mortgage creditors before current expenses are paid, the mortgage security is chargeable in equity with the restoration of any funds thus improperly diverted from their primary use. * * *"

This Court has, it is respectfully submitted, proceeded on the theory that when the earnings are diverted in favor of the bondholders, the bondholders receive more than they bargained for, and should in equity disgorge or restore the amount that they have unjustly received. Upon what other principle can the

expressions of this Court be sustained? A railroad has the right to mortgage its property, even to the extent of having the mortgage cover after acquired property. If the law is to be that it is unnecessary to show a diversion of earnings, the law in effect is that when a railroad company makes a mortgage and records it, that mortgage is not necessarily a mortgage even upon the real property described in it, no matter with what equity the mortgagee acts. This would be a subversion of the law and we respectfully submit the very contrary of what this Court meant by its expressions in Kneeland vs. American Loan Co. (*supra*).

What a court of equity may exact as a condition of complying with a request of a mortgagee for the appointment of a Receiver is not here in question.

It seems that the Court may grant to the Receiver a certain discretion as to the payments which he can make with the proceeds of the Receiver's certificates, in order to retain the good-will of the public. Apparently in the case at bar, the Receiver, although he at first thought that it might be necessary to pay six months' supply claims with the proceeds of the Receiver's certificates to retain that good-will, later concluded that it was only necessary to pay the labor claims. In effect, the case of Miltensberger vs. Logansport Railway Company (*supra*), relied upon by the petitioner, was such a case. There the controversy was concerning the allowances out of the fund of Receiver's credits for payments made by him pursuant to orders of the Court which were made about the inception of the receivership. The creditors who were paid were paid at the beginning of the receivership because it was necessary to retain their good-will in order to operate the

road. All that the Court in effect there held was that the Receiver had not improperly exercised his discretion.

The only ground upon which the petitioner can seriously claim that this Court will review the decision below is that of a diversity of decisions in the different Circuit Courts of Appeals, and the diversity which he in his brief shows is a diversity of decisions dealing simply with the right of preferential claims to a lien upon the corpus and not with what a court of equity may exact as a condition of appointing a Receiver.

The distinction above pointed out is well illustrated by the opinion of the Circuit Court of Appeals for the Fifth Circuit, in Cutting vs. Tavarez, O. & A. R. Co. (Flor. Cent. & P. R. R. Co., intervenors), 61 Fed. Rep., 150, which case is not cited by the petitioner, but is proof that the Sixth Circuit does not stand alone in its interpretation of this Court's opinions. There the Court said, at page 156:

> "*As the court in appointing the receiver made no provision for the payment of such claims and as there is no evidence in the record tending to show that current earnings either before or after the receiver was appointed were diverted* to paying any unearned interest, or, in fact, any interest upon the bonded debt, we are unable to sanction the order authorizing payment of such claims from the proceeds of the sale of the property. See Fosdick v. Schall, 99 U. S., 235." (Italics ours.)

THIRD POINT.

The points III., IV. and V., made by the petitioner at pages 13 to 17 of his brief, are not points which show that this is a case which this Court should, upon the principles which it has laid down, take up for review.

The petitioner's claim was not provided for in the order authorizing the borrowing of $35,000, as that money was to be used simply to pay obligations upon equipment trusts and payrolls (Record, p. 25, lines 37–44). The order authorizing the borrowing of $200,000 did not specifically authorize the use of any of that money to pay such a claim as the petitioner's, and it also provided that the Receiver should only use as much as he found *necessary*. He apparently did not find it necessary to pay supply claims (see end of Statement and end of Second Point). If there was ever any merit in the petitioner's Point III., he failed to assert it at the proper time. He has not been injured by the issuance of the Receiver's certificates. Although they were paid out of the proceeds of the *corpus* of the property, there was left from the proceeds of sale money sufficient to pay this claim, if it was entitled to be paid. The expenditures by the Receiver also enabled the Receiver to earn moneys against which the petitioner still retains his claim. Moreover, the laborers' claims were, as appears from the first order authorizing the Receiver's certificates, paid because their being paid was made practically a condition of appointing the Receiver, the money for their payment being authorized in the order appointing the Receiver. Any one who contends that there is no greater equity in a wage-earner's claim that in that

of a supply man, is far from expressing the common point of view, which admits that a discretion can be exercised between the two. As to Point IV., if there is any special equity to the extent of $3,200, it is a special equity against the receivership surplus earnings.

LAST POINT.

The respondents cannot refrain from pointing out to this Honorable Court the unfairness to them if this case is to be brought up to this Court for review. When the order was made distributing the proceeds of the sale, a large sum of money sufficient to pay this and similar claims was set aside to await the determination of an appeal to be taken by the petitioner, or other like claimants. Such an appeal was taken, and was unsuccessful, and a motion for a rehearing was made and denied, and this proceeding has now been brought. Since the Circuit Court made the order of distribution, the fund of money to pay these claims has been and still is in court. If the petitioner's request is granted the money will continue in court to the prejudice of these respondents and their beneficiaries who are its adjudged distributees, who have already been successful before the Master, before the Circuit Court, and before the Circuit Court of Appeals, and who have only the one fund out of which to have their claims satisfied, while, as shown above, the petitioner has another ample and entirely untried fund out of which he may seek to have his claim satisfied.

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